

# Credit card penalties, fees bury debtors

**Debate intensifies as Senate considers bankruptcy curbs**

By Kathleen Day and Caroline E. Mayer

[The Washington Post](#)

Updated: 12:01 a.m. ET March 6, 2005

WASHINGTON - For more than two years, special-education teacher Fatemeh Hosseini worked a second job to keep up with the \$2,000 in monthly payments she collectively sent to five banks to try to pay \$25,000 in credit card debt.

Even though she had not used the cards to buy anything more, her debt had nearly doubled to \$49,574 by the time the Sunnyvale, Calif., resident filed for bankruptcy last June. That is because Hosseini's payments sometimes were tardy, triggering late fees ranging from \$25 to \$50 and doubling interest rates to nearly 30 percent. When the additional costs pushed her balance over her credit limit, the credit card companies added more penalties.

"I was really trying hard to make minimum payments," said Hosseini, whose financial problems began in the late 1990s when her husband left her and their three children. "All of my salary was going to the credit card companies, but there was no change in the balances because of that interest and those penalties."

## Cycle of debt

Punitive charges — penalty fees and sharply higher interest rates after a payment is late — compound the problems of many financially strapped consumers, sometimes making it impossible for them to dig their way out of debt and pushing them into bankruptcy.

The Senate is to vote as soon as this week on a bill that would make it harder for individuals to wipe out debt through bankruptcy. The Senate last week voted down several amendments intended to curb excessive fees and other practices that critics of the industry say are abusive. House leaders say they will act soon after that, and President Bush has said he supports the bill.

Bankruptcy experts say that too often, by the time an individual has filed for bankruptcy or is hauled into court by creditors, he or she has repaid an amount equal to their original credit card debt plus double-digit interest, but still owes hundreds or thousands of dollars because of penalties.

"How is it that the person who wants to do right ends up so worse off?" Cleveland Municipal Judge Robert J. Triozzi said last fall when he ruled against Discover in the company's breach-of-contract suit against another struggling credit cardholder, Ruth M. Owens.

Owens tried for six years to pay off a \$1,900 balance on her Discover card, sending the credit company a total of \$3,492 in monthly payments from 1997 to 2003. Yet her balance grew to \$5,564.28, even though, like Hosseini, she never used the card to buy anything more. Of that total, over-limit penalty fees alone were \$1,158.

Triozzi denied Discover's claim, calling its attempt to collect more money from Owens "unconscionable."

## Credit firms seek curbs on bankruptcy

The bankruptcy measure now being debated in Congress has been sought for nearly eight years by the credit card industry. Twice in that time, versions of it have passed both the House and Senate. Once, President Bill Clinton refused to sign it, saying it was unfair, and once the House reversed its vote after Democrats attached an amendment that would prevent individuals such as anti-abortion protesters from using bankruptcy as a shield against court-imposed fines.

Credit-card companies and most congressional Republicans say current law needs to be changed to prevent abuse and make more people repay at least part of their debt. Consumer-advocacy groups and many Democrats say people who seek bankruptcy protection do so mostly because they have fallen on hard times through illness, divorce or job loss. They also argue that current law has strong provisions that judges can use to weed out those who abuse the system.

Opponents also argue that the legislation is unfair because it ignores loopholes that would allow rich debtors to shield millions of dollars during bankruptcy through expensive homes and complex trusts, while ignoring the need for more disclosure to cardholders about rates and fees and curbs on what they say is irresponsible behavior by the credit card industry. The Republican majority, along with a few Democrats, has voted down dozens of proposed amendments to the bill, including one that would make it easier for the elderly to protect their homes in bankruptcy and another that would require credit card companies to tell customers how much extra interest they would pay over time by making only minimum payments.

### **'Arm-twisting' leads to higher payments**

No one knows how many consumers get caught in the spiral of "negative amortization," which is what regulators call it when a consumer makes payments but balances continue to grow because of penalty costs. The problem is widespread enough to worry federal bank regulators, who say nearly all major credit card issuers engage in the practice.

Two years ago regulators adopted a policy that will require credit card companies to set monthly minimum payments high enough to cover penalties and interest and lower some of the customer's original debt, known as principal, so that if a consumer makes no new charges and makes monthly minimum payments, his or her balance will begin to decline.

Banks agreed to the new rules after, in the words of one top federal regulator, "some arm-twisting." But bank executives persuaded regulators to allow the higher minimum payments to be phased in over several years, through 2006, arguing that many customers are so much in debt that even slight increases too soon could push many into financial disaster.

### **Firms defend fees**

Credit card companies declined to comment on specific cases or customers for this article, but banking industry officials, speaking generally, said there is a good reason for the fees they charge.

"It's to encourage people to pay their bills the way they said they would in their contract, to encourage good financial management," said Nessa Feddis, senior federal counsel for the American Bankers Association. "There has to be some onus on the cardholder, some responsibility to manage their finances."

High fees "may be extreme cases, but they are not the trend, not the norm," Feddis said.

"Banks are pretty flexible," she said. "If you are a good customer and have an occasional mishap, they'll waive the fees, because there's so much competition and it's too easy to go someplace else." Banks are also willing to work out settlements with people in financial difficulty, she said, because "there are still a lot of options even for people who've been in trouble."

Many bankruptcy lawyers disagree. James S.K. "Ike" Shulman, Hosseini's lawyer, said credit card companies hounded her and did not live up to several promises to work with her to cut mounting fees.

Regulators say it is appropriate for lenders to charge higher-risk debtors a higher interest rate, but that negative amortization and other practices go too far, posing risks to the banking system by threatening borrowers' ability to repay their debts and by being unfair to individuals.

### **Debtors to blame?**

U.S. Bankruptcy Judge David H. Adams of Norfolk, who is also the president of the National Conference

of Bankruptcy Judges, said many debtors who get in over their heads "are spending money, buying things they shouldn't be buying." Even so, he said, "once you add all these fees on, the amount of principal being paid is negligible. The fees and interest and other charges are so high, they may never be able to pay it off."

Judges say there is little they can do by the time cases get to bankruptcy court. Under the law, "the credit card company is legally entitled to collect every dollar without a distinction" whether the balance is from fees, interest or principal, said retired U.S. bankruptcy judge Ronald Barliant, who presided in Chicago. The only question for the courts is whether the debt is accurate, judges and lawyers say.

John Rao, staff attorney of the National Consumer Law Center, one of many consumer groups fighting the bankruptcy bill, says the plight consumers face was illustrated last year in a bankruptcy case filed in Northern Virginia.

Manassas resident Josephine McCarthy's Provident Visa bill increased to \$5,357 from \$4,888 in two years, even though McCarthy has used the card for only \$218.16 in purchases and has made monthly payments totaling \$3,058. Those payments, noted U.S. Bankruptcy Judge Stephen S. Mitchell in Alexandria, all went to "pay finance charges (at a whopping 29.99%), late charges, over-limit fees, bad check fees and phone payment fees." Mitchell allowed the claim "because the debtor admitted owing it." McCarthy, through her lawyer, declined to be interviewed.

### **Principle of a loan**

Provident Financial Corp. spokesman Alan Elias said: "When consumers sign up for a credit card, they should understand that it's a loan, no different than their mortgage payment or their car payment, and it needs to be repaid. And just like a mortgage payment and a car payment, if you are late you are assessed a fee." The 29.99 percent interest rate, he said, is the default rate charged to consumers "who don't meet their obligation to pay their bills on time" and is clearly disclosed on account applications.

Feddis, of the banker's association, said the nature of debt means that interest will often end up being more than the original debt. "Anytime you have a loan that's going to extend for any period of time, the interest is going to accumulate. Look at a 30-year-mortgage. The interest is much, much more than the principal."

Samuel J. Gerdano, executive director of the American Bankruptcy Institute, a nonpartisan research group, said that focusing on late fees is "refusing to look at the elephant in the room, and that's the massive levels of consumer debt which is not being paid. People are living right up to the edge," failing to save so when they lose a second job or overtime, face medical expense or their family breaks up, they have no money to cope.

"Late fees aren't the cause of debt," he said.

### **'Fee feeding frenzy'**

Credit card use continues to grow, with an average of 6.3 bank credit cards and 6.3 store credit cards for every household, according to Cardweb.com Inc., which monitors the industry. Fifteen years ago, the averages were 3.4 bank credit cards and 4.1 retail credit cards per household.

Despite, or perhaps because of, the large increase in cards, there is a "fee feeding frenzy," among credit card issuers, said Cardweb president and chief executive Robert McKinley. "The whole mentality has really changed over the last several years," with the industry imposing fees and increasing interest rates if a single payment is late.

Penalty interest rates usually are about 30 percent, with some as high as 40 percent, while late fees now often are \$39 a month, and over-limit fees, about \$35, McKinley said. "If you drag that out for a year, it could be very damaging," he said. "Late and over-limit fees alone can easily rack up \$900 in fees, and a 30 percent interest rate on a \$3,000 balance can add another \$1,000, so you could go from \$2,000 to \$5,000 in just one year if you fail to make payments."

According to R.K. Hammer Investment Bankers, a California credit card consulting firm, banks collected \$14.8 billion in penalty fees last year, or 10.9 percent of revenue, up from \$10.7 billion, or 9 percent of revenue, in 2002, the first year the firm began to track penalty fees.

The way the fees are now imposed, "people would be better off if they stopped paying" once they get in over their heads, said North Carolina bankruptcy attorney T. Bentley Leonard. Once you stop paying, creditors write off the debt and sell it to a debt collector. "They may harass you, but your balance doesn't keep rising. That's the irony."

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